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September 6, 1996

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

BY HAND

William F. Caton
Acting Secretary
1919 M Street NW, Room 222
Washington, D.C. 20554
Federal Communications Commission

Re: CS Docket Nos. 95-184

Dear Mr. Caton:

On September 6, 1996, Michael Katzenstein of OpTel, Inc., and Henry Goldberg met with John Logan, Deputy Chief, Cable Services Bureau, Rick C. Chessen, Assistant Chief, Cable Services Bureau, and their staff, regarding the application of the Commission's fresh look doctrine to perpetual contracts for multichannel video programming services. The substance of the issues discussed is contained in an *ex parte* letter filed in this proceeding on behalf of OpTel on July 23, 1996, a copy of which is attached hereto.

Respectfully,

W. K. Ferree

/s/ W. Kenneth Ferree
Attorney for OpTel, Inc.

cc: John Logan

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JUL 23 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

July 23, 1996

EX PARTE

Ms. Meredith Jones
Chief, Cable Services Bureau
Federal Communications Commission
2033 M Street, N.W. - Room 918
Washington, D.C.

Re: CS Docket No. 95-184: Application of "Fresh Look" to Cable Perpetual Contracts

Dear Ms. Jones:

This letter follows-up on the discussion that we had when Mike Katzenstein of OpTel, Inc., ("OpTel") and Don Simons of MultiTechnology Services, L.P. ("MTS") met with you and your staff on June 27, 1996. That discussion dealt with the application of the Commission's "fresh look" policy to perpetual service contracts between franchised cable operators and multiple dwelling unit ("MDU") owners and ownership associations. In addition, OpTel's recent comments in CS Docket No. 96-133 discuss application of the fresh look policy as a means of reducing the dominance of franchised cable operators in the multichannel video programming distribution ("MVPD") market.[1]

BACKGROUND

By way of background, with the above-referenced Notice of Proposed Rulemaking ("NPRM"), the Commission has initiated a review of the rights of service providers to obtain access to MDUs. One possibility raised by the Commission in the NPRM is the establishment of a federal right of "mandatory access," which would require property owners to open their property to all service

[1] See Comments of OpTel, Inc. in CS Docket No. 96-133, filed July 19, 1996.

providers. OpTel and MTS, and the Independent Cable & Telecommunications Association ("ICTA"), the industry association of the private cable industry, strongly oppose such a requirement, as set out fully in their respective comments in response to the NPRM.

Briefly summarizing those comments, Commission-imposed mandatory access would inhibit, rather than promote, the development of competition in the MVPD market.[2] The economics of the MDU marketplace require the use of exclusive service agreements, which are the norm at MDUs, both for franchised cable operators and private cable companies, such as OpTel and MTS, but are particularly important for private cable. Private cable companies must install and maintain an entire distribution network at each property. Although a franchised cable operator can amortize the cost of serving an MDU over its entire franchise area, private cable companies must recoup their investment through each MDU served. Thus, exclusivity, for a reasonable period of years, is essential to the ability of alternative video programming distributors to compete.

The availability of exclusive rights-of-entry also allows MDU property owners and ownership associations to bargain with service providers for superior video and telecommunications services for MDU tenants and residents. These services enhance the property's attractiveness to tenants and residents, which is a competitive necessity in today's marketplace. Owners and ownership associations are charged with ensuring the highest level of video and telecommunications services at their properties. They are well aware of the marketplace for these services and bargain for one-stop-shopping options that the private cable industry provides today. Owners know that to provide these enhanced services, the service providers often must have a fixed period of exclusivity, subject to maintaining strict performance and price standards, which are set out in the service contracts, to amortize their substantial investments. A mandatory access requirement would deprive property owners and ownership associations of an essential tool in the competition for MDU residents.

It is not exclusive contracts that are the problem in the MVPD market, but perpetual, exclusive contracts. By perpetual contracts, we mean contracts that effectively have no fixed term, but are open-ended and bind the parties in perpetuity.[3] Typically, the exclusive contracts used by the franchised cable operator between 1970 and 1990 run for the term of the cable operator's franchise and any renewals or extensions thereof. Because franchise renewals and extensions

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[2] Mandatory access requirements also would constitute a *per se* "taking" of private property. Lacking clear statutory authority, the Commission may not effect such a taking. See Bell Atlantic Tel. Co. v. FCC, 24 F.3d 1441, 1445 (D.C. Cir. 1994).

[3] It also should be noted that these perpetual agreements, unlike the contracts typical in the private cable industry, contain no contractual performance standards requiring the cable operator to maintain state-of-the art technology and "state-of-the market" pricing.

are all but automatic, the terms of these contracts are, for all practical purposes, perpetual.

In this regard, perpetual, exclusive contracts foreclose a large segment of the MDU market, and access to countless consumers, to competitors of the franchised cable operators. Even in states in which there is a general public policy against perpetual contracts, the franchised cable operators' threats of litigation over breach of contract and over tortious interference with contract exercise a kind of *in terrorem* control over competitive access to the MDU; making it uneconomic for both the MDU owner and the competitor to challenge the legality of the perpetual contract.

In today's informed and competitive marketplace, virtually no property owner or ownership association signs perpetual contracts. Most perpetual contracts were executed in the 1970s and 1980s before competitive alternatives to franchised cable were available. At that time, franchised cable operators were able to approach MDUs with a deal that only a monopolist can offer: Take our service on our terms, exclusively, in perpetuity, or leave your residents entirely without television service. Given their unequal bargaining power, MDU managing agents were compelled to accept service on these terms.

Now, when there are an increasing number of competitive alternatives to the franchised cable operators to serve the telecommunications needs of MDU residents, the established base of perpetual, exclusive contracts represents a substantial barrier to competitive entry. It is this barrier to entry, made up of old contracts, that the Commission should deal with on a one-time basis and not affect the present and future contracting ability and private property rights of MDU owners and service providers in an increasingly competitive marketplace.

Although a mandatory access requirement would eliminate perpetual contracts, it also would sweep in a wide variety of pro-competitive, non-perpetual exclusive contracts. Consequently, OpTel and MTS suggest that, rather than impose a mandatory access regime, the Commission should apply a "fresh look" policy to those perpetual contracts that now are in effect and then allow parties to contract as they see fit in response to consumer demands and needs in the marketplace.

FRESH LOOK

The Commission previously has imposed "fresh look" obligations on dominant telecommunications providers to prevent them from using their market power in anticompetitive ways.[4] "Fresh look" allows customers committed to long-term contracts with a dominant provider to take a fresh look at the marketplace

[4] See Competition in the Interstate Interexchange Marketplace, 7 FCC Rcd 2677, 2678 (1992); Expanded Interconnection with Local Tel. Co. Facilities, 8 FCC Rcd 7341, 7342-43 (1993), vacated on other grounds, Bell Atlantic Tel. Co. v. FCC, 24 F.3d 1441 (1994).

once competition is introduced and to escape or renegotiate those contracts if they so desire. This approach "makes it easier for an incumbent provider's established customers to consider taking service from a new entrant.... [and] obtain ... the benefits of the new, more competitive ... environment."[5]

Application of the "fresh look" doctrine generally involves two steps. First, the entity subject to fresh look requirements is prohibited from engaging in some future conduct that might defeat or substantially delay the introduction of competition.[6] Second, the entity is required to allow its customers who are committed to contracts that extend into the competitive era to opt-out of those contracts during a "fresh look" period, with little or no termination liability.[7]

In this case, there is little doubt that the franchised cable operator has a dominant position in the market. The Commission, the Department of Justice, and the courts repeatedly have found, franchised cable operators are the dominant providers in the MVPD market.[8] The existence of perpetual contracts, moreover, allows franchised cable operators to maintain their dominant position, particularly because most private cable operators do not even attempt to compete for MDUs that are bound up in perpetual contracts. There will not be significant competition in the MDU market until the barrier to entry represented by perpetual contracts is eliminated.

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[5] Expanded Interconnection with Local Tel. Co. Facilities, 9 FCC Rcd 5154, 5207 (1994).

[6] For instance, in Competition in the Interstate Interexchange Marketplace, the Commission found that, because 800 numbers were not portable (*i.e.*, customers could not change from one 800 service provider to another without also changing 800 numbers), AT&T could improperly leverage its market power in 800 services in its contract negotiations. Competition in the Interstate Interexchange Marketplace, 6 FCC Rcd at 5880, 5905. Thus, until 800 number portability became available, the Commission prohibited AT&T from bundling 800 service with any other service.

[7] For example, in Competition in the Interstate Interexchange Marketplace, the Commission required AT&T to allow customers that had contracted for 800 service prior to the implementation of 800 number portability to terminate those contracts during a "fresh look" period without termination liability. 7 FCC Rcd at 2677-78. Similarly, in Expanded Interconnection with Local Tel. Co. Facilities, the Commission found that local exchange carriers' "long-term access arrangements [raised] potential anticompetitive concerns since they tend to 'lock up' the access market, and prevent customers from obtaining the benefits of the new, more competitive interstate access environment." 7 FCC Rcd at 7463. The Commission, therefore, decided that customers with such long-term access arrangements could terminate those contracts during a "fresh look" period with limited liability and "avail themselves of a competitive alternative."

[8] See In re Revision of Rules and Policies for the Direct Broadcast Satellite Service, IB Docket No. 95-168, PP Docket No. 93-253, Comments of the United States Department of Justice at 2 (filed Nov. 20, 1995); In re Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 95-61, ¶ 215 (rel. Dec. 11, 1995); Turner Broadcasting v. FCC, 910 F. Supp. 734, 740 (D.D.C. 1995).

Despite the dominance of the franchised cable operator, OpTel and MTS are not seeking to implement the first step of the "fresh look" doctrine and prohibit perpetual right-of-entry agreements between franchised cable operators and MDU owners. Rather, OpTel and MTS are prepared to rely on the marketplace and not regulation to govern the relationship between MDU owners and ownership associations on a going-forward basis. Imposition of the second step of the "fresh look" doctrine, however, is essential to achieve this deregulatory outcome. Therefore, the Commission should require franchised cable operators with perpetual contracts to allow their customers to opt-out of those contracts with no adverse contractual consequences.

As in previous "fresh look" instances in which the fresh look doctrine has been applied, the customers of dominant service providers should be given a fixed period of time within which to opt-out of their contracts. In Competition in the Interstate Interexchange Marketplace, the Commission determined that a ninety-day "fresh look" period was sufficient for long-distance customers to evaluate their options and negotiate new contracts when 800 numbers became portable.[9] When the Commission later confronted expanded interconnection to local exchange facilities, it provided for a 180-day "fresh look" window, recognizing that it would take longer than ninety days for the market to respond to expanded interconnection opportunities.[10]

The characteristics of the MVPD marketplace require that the "fresh look" window in this case should be at least 180 days. As the Commission's decision in the Expanded Interconnection proceeding makes clear, the duration of the "fresh look" period should, in part, be predicated on the time it will take competitors to add capacity and meet increased demand in the particular market. In the MVPD market, it may take a new entrant several months to obtain necessary approvals and construct the facilities needed to serve any given MDU. Thus, a three month "fresh look" window would be inadequate.

Further, the fact that franchised cable operators hold a series of dispersed monopolies rather than a single national monopoly requires that the "fresh look" window be tailored to the local MVPD markets. For instance, in previous applications of the "fresh look" doctrine, the Commission has initiated the "fresh look" period when the dominant national service provider was first subject to competition. In this case, however, MDU owners and ownership associations must be freed from their perpetual contracts in order to create competition in each locality.

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9 See 6 FCC Rcd at 5906.
10 See 8 FCC Rcd at 7353 & n.48.

Thus, prior to the time when the franchised cable operator is subject to "effective competition" under Section 623 of the Communications Act,[11] the "fresh look" window should be "opened" at any given MDU upon the request of a private cable company able to serve the MDU in question. Moreover, once a franchised cable operator is subject to "effective competition" under the Act, even if there as been no specific request from a private cable company, the fresh look window should be opened six months from the date that there has been an "effective competition" determination. During this period, the property owner or ownership association could renegotiate or terminate its contract with the franchised cable operator free from contractual penalties or breach of contract litigation.

Application of the "fresh look" doctrine will allow the Commission to cease to regulate in this area entirely once there is actual or "effective" competition. At that point, MDU owners and ownership associations which enter into disadvantageous service contracts for their buildings do so, presumably, with full knowledge that competitive alternatives exist. The residential real estate market will self-regulate against MDU owners and ownership associations prone to such an error.

LEGAL AUTHORITY

The Commission has ample authority to apply its "fresh look" doctrine in the MVPD context. Under Title VI, the Commission is required to ensure that the rates charged to subscribers by cable systems not subject to effective competition are reasonable.[12] Although previous "fresh look" cases involved the regulation of common carriers under Title II of the Communications Act, the Commission's responsibility to regulate cable rates under Title VI is comparable.[13]

In its "fresh look" proceedings under Title II, the Commission has held that the use of long-term contracts to leverage market power from a non-competitive market into a competitive one, or from a market that is not yet competitive into the future, is an unjust and unreasonable practice.[14] It is no less unreasonable in the Title VI context. Application of the "fresh look" doctrine is necessary to eliminate the market barrier erected by franchised cable operators between their captive customers and competing MVPD service providers.

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11 47 C.F.R. § 543(l).

12 47 U.S.C. § 543(b).

13 Cf. Implementation of Section of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, 8 FCC Rcd 5631, 5723 (1993) (analogizing rate prescription under Title VI to rate prescription under Title II).

14 See Competition in the Interstate Interexchange Marketplace, 7 FCC Rcd at 2682; Expanded Interconnection with Local Tel. Co. Facilities, 8 FCC Rcd at 7348.

In addition, application of the "fresh look" policy to the perpetual service contracts of franchised cable operators would help the Commission to fulfill its obligations under Section 257 of the Communications Act, supplemented by the Telecommunications Act of 1996, which requires that the Commission identify and eliminate market entry barriers for entrepreneurs and small businesses.[15] Only by opening up the perpetual service contracts of the franchised cable operators will new entrants into the MVPD market have an opportunity to compete.

For the reasons set forth above, OpTel and MTS urge the Commission to restrict future perpetual contracts for MDU video programming service by any cable operator not subject to effective competition and to apply its "fresh look" policy to all such existing perpetual contracts.

Respectfully,

/s/ Henry Goldberg

cc: William F. Caton
William E. Kennard, Esq.
Robert M. Pepper

[15] 47 U.S.C. § 257(a).